Internal Revenue Service

memorandum

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CC:TL:TS/WHEARD

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to: District Counsel, Dallas SW:DAL

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted] Project/ TEFRA Issues

This is in response to your request for technical advice dated August 15, 1988.

ISSUES

1. Who is the Tax Matters Partner of a source "first tier" partnership when the sole general partner is in bankruptcy?

2. If the TMP of the source partnership is a "second tier" general or limited partnership, who may act on behalf of the second tier partnership in its capacity as TMP for the first tier partnership?

3. May the Service designate an indirect partner as the TMP?

4. May the Service appoint a TMP for a later year when an earlier year is in litigation?

5. Where should a generic TMP notice be sent when the Service knows that the partnership address is no longer correct?

CONCLUSIONS

1. A sole general partner who files for bankruptcy is immediately reselected as TMP under the largest profits interest general partner rule notwithstanding that he is treated as having a zero profits interest. See I.R.C. § 6231(a)(7); Temp. Treas. Reg. § 301.6231(a)(7)-1T(m). No court has approved this position as of yet, however, and their is a substantial hazard of litigation to this position. For future cases the Service should designate a limited partner as TMP under the "impracticable" clause of section 6231(a)(7) in this situation. Rev. Proc. 88-16, 1988-9 I.R.B. 7.

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2. If the largest profits interest general partner of the source partnership is itself a partnership, then the TMP of the second tier partnership may act on behalf of the second tier partnership in its capacity as TMP of the source partnership. Any document signed on behalf of an entity TMP should make explicit that the signor is signing in a representative capacity on behalf of the entity TMP. Only a general partner of the source partnership (whether an individual, limited partnership, or general partnership) is automatically selected or reselected as a TMP under the largest profits interest general partner rule of section 6231(a)(7).

3. The Service may designated a limited or indirect partner of the source partnership as TMP only if it determines it is impracticable to apply the largest profits interest general partner rule. Such a selection may be appropriate where all general partners are treated as having no profits interest under the regulations or the TMP cannot be determined. PAE Enterprises v. Commissioner, T.C.M. 1988-222 (May 17, 1988), Slip op. at 6-7 (dicta); cf. Rev. Proc. 88-16.

4. The Service may designate a TMP for any year not currently in litigation. Computer Programs Lambda, Ltd., v. Commissioner, 90 T.C. No. 74 (June 2, 1988), Slip op. at 7, fn. 4.

5. A generic notice should be sent to the partnership's last know address as reported on the partnership return or as updated under Temp. Treas. Reg. § 301.6223(c)-1T.

DISCUSSION

1. A Bankrupt Sole General Partner is Reselected as TMP Under the Largest Profits Interest General Partner Rule

I.R.C. § 6231(a)(7) defines the term "tax matters partner" as follows:

> (7) TAX MATTERS PARTNER. - The tax matters partner of any partnership is -
> (A) the general partner designated as the tax matters partner as provided in regulations, or
> (B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the taxable year involved (or, where there is more than one such partner, the 1 of such partners whose name would appear first in an alphabetical listing).

If there is no general partner designated under subparagraph (A) and the Secretary determines that it is impracticable to apply subparagraph (B), the partner selected by the Secretary shall be treated as the tax matters partner.

Temp. Treas. Reg. § 301.6231(a)(7) - 1T(m) provides as follows:

(m) Tax matters partner where no partnership designation made--(1) In general. The tax matters partner for a partnership taxable year shall be determined under this paragraph (m) if:

(i) The partnership has not designated a tax matters partner under this section for that taxable year; or

(ii) The partnership has designated a tax matters partner under this section for that taxable year, that designation has been terminated under paragraph (1) of this section, and the partnership has not made a subsequent designation under this section for that taxable year.

(2) General partner having the largest profits interest is the tax matters partner. The tax matters partner for any partnership taxable year to which this paragraph (m) applies is the general partner having the largest profits interest in the partnership at the close of that taxable year (or where there is more than one such partner, the one of such partners whose name would appear first in a an alphabetical listing). For purposes of this paragraph (m)(2), all limited partnership interests held by a general partner shall be included in determining that general partner's profits interest in the partnership.

(3) Termination of designation. A designation of a tax matters partner for a partnership taxable year under this paragraph (m) shall remain in effect until the earlier of the occurrence of one of more of the events described in paragraph (1)(1) through (4) or the day on which a designation under paragraph (d), (e), or (f) of this section becomes effective. If a designation of a tax matters partner for a partnership taxable year is terminated under this paragraph (m)(3) and the partnership has not subsequently designated a tax matters partner for that taxable year under paragraph (d), (e), or (f) of this section the tax matters partner for that taxable year shall be determined under paragraph (m)(2) of this section and

> for purposes of applying that paragraph (m)(2), the general partner whose designation was so terminated shall be treated as having no profits interest in the partnership for that taxable year. (emphasis supplied)

Paragraph (m)(3) includes in the events which terminate a designation under paragraph (m)(2) (the largest profits interest rule) an event under paragraph (l)(4) which provides:

> The partnership items of the tax matters partner become nonpartnership items under section 6231(c) (relating to special enforcement areas), . . .

Temp. Treas. Reg. § 301.6231(c)-7T(a), which was promulgated pursuant to the broad grant of regulatory authority that was given to the Secretary in sections 6231(c)(1)(E) and 6231(c)(2), provides as follows:

> (a) Bankruptcy. The treatment of items as partnership items with respect to a partner named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition naming the partner as debtor is filed in bankruptcy.

If a TMP files for bankruptcy his partnership items convert to nonpartnership items as of the date he files for bankruptcy. Temp. Treas. Reg. § 301.6231(c)-7T(a). The regulations provide that the designation of a TMP terminates upon the conversion of the TMP's partnership items to nonpartnership items. Temp. Treas. Reg. § 301.6231(a)(7)-1T(m)(3) and (l)(4).

Subparagraph (m) of the regulation provides guidance in determining which general partner is the tax matters partner by application of the largest profits interest rule when a prior designation either by the partnership or under the largest profits interest rule has terminated. The regulation under subparagraph (m)(3), for purposes of applying the largest profits interest formula of (m)(2), provides that the general partner whose designation was terminated under paragraph (l) shall be treated as having no profits interest in the partnership for that

taxable year. As a result, if there is any other general partner with any profits interest during that year, that general partner will be selected over the recently terminated general partner. The regulation will operate to re-select as tax matters partner a general partner whose partnership items have converted to nonpartnership items only in the case of a sole general partner.

If the regulation did not operate to re-select a bankrupt sole general partner, then the tax matters partner's unilateral, elective, and probably secret (to the IRS) decision to file a petition in bankruptcy would, in the case of a sole general partner, effectively insulate all limited partners from the notice procedures of section 6223, while the statute of limitations under section 6229 continues to run. This is because the period for assessment tolls upon the issuance of an FPAA to the TMP. Neither the code nor the regulations intend to give the petitioners the equivalent of a procedural atomic bomb.

The statute and regulations should be applied in such a way to re-select the TMP who is now personally disinterested but who is nevertheless charged with a fiduciary duty towards others, rather than leave the partnership with an unfillable void in the critical office of tax matters partner.1/ See Computer Programs Lambda v. Commissioner, 89 T.C. 198, 205 (1987). The TEFRA partnership procedures contemplate the continual presence of a tax matters partner. Id.

Finally, 11 U.S.C. § 362(a)(8) (1982), which provides for an automatic stay of the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor, does not apply. Arguably, since a general partner's partnership items are converted to nonpartnership items when it files its petition in bankruptcy, the District Court proceeding would not be "concerning" the reselected general partner as a debtor. 2/ But see Computer Programs Lambda v. Commissioner, supra at 206 (a contrary inference can be drawn). In such a case, subsequent to the bankruptcy petition, the reselected TMP

1/ It should be noted that the code does not require that the tax matters partner have a personal stake in the outcome of the proceeding in order to file a petition or to intervene in a notice partner's action. I.R.C. §§ 6226(a) and 6226(b)(5). Section 6226(d) does not limit either right. Computer Programs Lambda v. Commissioner, 89 T.C. 198, 204-205 (1987).

2/ See In re Brandt-Airflex Corp., 843 F.2d 90, 95-96 (2d Cir. 1988); American Principals Leasing Corporation, et al. v. United States, Case. No. 88-0101-GT(M), ORDER (DC SD Cal July 8, 1988)(partnership proceeding is a determination of tax liability of non-debtor partners and, thus, Bankruptcy Court has no jurisdiction over partnership proceeding).

will have no financial interest in the outcome and can only act in its role of fiduciary for the limited partners in the partnership. See Computer Programs Lambda v. Commissioner, supra at 205.

The automatic stay may apply to the District Court proceeding since the debtor acting as fiduciary would be expending his funds on behalf of other partners which action would obviously be of interest to the Bankruptcy Court. This would impact adversely on the Tax Court's ability to manage its case load if the bankruptcy stay came into play in unified partnership cases. Nevertheless, the ability to issue a valid notice at all times is critical to the working of the statute. Therefore, we favor this approach even if it leads to the occasional application of the automatic stay provisions to a Tax Court proceeding.

2. The TMP of the second tier partnership can act on behalf of the second tier partnership in its capacity as TMP for the first tier or source partnership

If a second tier partnership is TMP for the first tier partnership, the issue arises as to who can act on the second tier partnership's behalf in its capacity as TMP of the first tier. Generally, under state law, any general partner is authorized to bind a partnership. Thus, theoretically, any general partner of a second tier TMP could act on behalf of the second tier as the TMP of the first tier. Several problems arise in this context, however.

The first problem is that the parameters of each general partners's authority to not only bind the second tier partnership but all the partners of the first tier (e.g., through an extension of the period for assessment under section 6229(a) for all partners) is untested.

A second problem would be that this interpretation could, in effect, make all the general partners of the second tier into TMPs for the first tier. The code and regulations contemplate the existence of one TMP through which the Service can deal with the partnership and through which the partnership can deal with the Service.

Having, in effect, multiple TMPs conflicts with this policy and would also raise issues of fairness and administrative efficacy. Conflicting authorizations could occur. A general partner with a minuscule interest who was neither selected as TMP by his fellow partners, nor authorized to extend the statute for his fellow partners, and was not even the largest profits interest TMP of the second tier, could bind all direct and indirect partners to a statute extension.

Where partners designate a second tier partnership as TMP or that partnership is selected as TMP under the largest profits interest rule, ideally, the second tier partnership would authorize one partner to fill the function of TMP of the first tier on the second tier's behalf. When the second tier partnership designates its own TMP, this should act as such an authorization. Such a designation or selection under the largest profits interest rule is for the purpose of authorizing a partner to handle the tax matters of the second tier partnership which would necessarily include tax activities with respect to the source partnership. Thus, dealing with the TMP of the second tier as the functional equivalent of the TMP of the first tier, as a practical and legal matter, should be least subject to challenge and would probably be favored by the court.

Thus, when a second tier partnership is TMP of a first tier, the TMP of the second tier will be able to act on behalf of the second tier in its capacity as TMP for the first tier. We do not recommend dealing with a non-TMP general partner notwithstanding that his actions may be binding on the second tier TMP partnership. We will defend a statutory extension signed on behalf of a TMP partnership by a general partner, however.

Whenever a lower tier partner signs a statutory extension on behalf of all partners of the first (source) tier, the fact that he is signing in a representative capacity should be made explicit, e.g., general partner A signing on behalf of partnership B which is signing as TMP of partnership C, which is signing as TMP of partnership D the source partnership. See Computer Programs Lambda, Ltd., v. Commissioner, 89 T.C. 798 (1987)(signature of president of corporation "as TMP" rather than "on behalf of TMP corporation" caused petition to be invalid).

3. The Service May Designate An Indirect (i.e., third or fourth tier) Partner as TMP if it is Impracticable to Apply the Largest Profits Interest General Partner Rule

Section 6231(a)(7) states in part that if "the Secretary determines that it is impracticable to apply [the largest profits interest general partner rule] the partner selected by the Secretary shall be treated as the" TMP.

A "partner" is defined as "a partner in the partnership" and "any other person whose income tax liability under subtitle A is determined in whole or part by taking into account directly or indirectly partnership items of the partnership." I.R.C. § 6231(a)(2). A taxpayer holding an interest in a source partnership through an intermediary or "flow through" partnership would have his tax liability determined indirectly through the flow through partnership. Furthermore, if the indirect partner is identified in accordance with section 6223(c) his tax liability will be determined directly with respect to the source partnership. I.R.C. § 6223(c) (for purposes of partnership

partnership. I.R.C. § 6223(c) (for purposes of partnership provisions Service must use names and profits interests of indirect partners in lieu of pass-thru partnership where names, profits interests, etc. of indirect partners have been provided on return or in accordance with regulations). Thus, a taxpayer holding an interest in a source (first tier) partnership will be considered to be a partner of that partnership notwithstanding that he holds his interest through one or more pass through partnerships.

Since an indirect partner is a "partner" in the first tier partnership under section 6231(a)(2)(B), the Service may designate an indirect partner as TMP where it determines it is impracticable to apply the largest profits interest rule. See PAE Enterprises v. Commissioner, T.C.M. 1988-222 (May 17, 1988), Slip op. at 6 (dicta); cf. Rev. Proc. 88-16 (Service may designate limited partner as TMP when impracticable to apply largest profits interest general partner rule). However, where a general partner having a profits interest greater than zero is available, such a designation under the "impracticable" clause of section 6231(a)(7) may be an abuse of discretion. PAE Enterprises, supra, Slip op. at 7 (dicta). Where no general partner is treated as having a profits interest, however, such a designation should be permissable.

4. The Service may designate a TMP for any year not currently in litigation.

Under the "impracticable" clause discussed above the Service may designate a limited partner to serve as TMP when there is no general partner available or the general partners are all treated as having no profits interest. The Tax Court has noted, however, that it is inappropriate for the Service to chose a TMP under the "impracticable" rule when the taxable year involved is in litigation. Computer Programs Lambda, Ltd., v. Commissioner, 90 T.C. No. 74 (June 2, 1988), Slip op. at 7. In this regard the Court stated:

> Where a partnership is without a tax matters partner before this Court, we believe it is more appropriate for the Court to appoint the partnership's tax matters partner, rather than for respondent to make the appointment because respondent is the partnership's adversary during litigation. An adversary should not appoint an opponent's representative.4

[Footnote 4 continued] **This adversariness does not prevent the appointment during**

> **administrative proceedings because there is no certainty that the proceeding will result in litigation.** [citation deleted; emphasis supplied]

Under the above rationale the Service should be able to designate a TMP for any taxable year not in litigation, notwithstanding that an earlier year is in litigation.

5. A generic notice should be sent to the partnership's last know address as reported on the partnership return or as updated under Temp. Treas. Reg. § 301.6223(c)-1T.

Section 6223(c) provides:

> **Information base for Secretary's Notices, Etc.**-For purposes of this subchapter.-
>
> > **(1) Information of partnership return.**-Except as provided in paragraphs (2) and (3), the Secretary shall use the names, addresses, and profits interests shown on the partnership return.
> >
> > **(2) Use of additional information.**-The Secretary shall use additional information furnished to him by the tax matters partner or any other person in accordance with regulations prescribed by the Secretary.
> >
> > **(3) Special rule with respect to indirect partners . . .** [etc.] ____

Temp. Treas. Reg. § 301.6223(a)-1T provides:

> **Notice sent to tax matters partner (Temporary).**-(a) In general. For purposes of subchapter C of chapter 63 of the Code, a notice is treated as mailed to the tax matters partner on the earlier of-
>
> > (1) The date on which the notice is mailed to the "TAX MATTERS PARTNER" at the address of the partnership **(as provided on the partnership return, except as updated under § 301.6223(c)-1T)** [emphasis supplied], or

> (2) The date on which the notice is mailed to the person who is the tax matters partner at the address of that person (as provided on the partner's return, except as updated under § 301.6223(c)-1T) or the partnership. See § 301.6223(c)-1T for rules relating to the information to be used by the Service in providing notices, etc.
>
> . . .

Section 301.6223(c)-1T(a) through (e) provides for the manner in which a statement can be filed with the Service updating information on the partnership return. Subsection (f) provides that the Service may use other information in its possession (such as a change of address reflected on a partner's return) but is not obligated to search its records for information not expressly furnished under the preceding provisions.

Thus, the Service must use the address of the partnership shown on the partnership return unless a new address is furnished under section 301.6223(c)-1T or the Service discovers a correct address. An FPAA sent in accordance with the above regulations will toll the statute of limitations.

We advise that an FPAA also be sent to the tax matters partner by name at the partner's address if the tax matters partner can be determined. If all general partners are treated as having a zero profits interest it is appropriate for the Service to select a TMP under the impracticable clause of section 6231(a)(7). See Rev. Proc. 88-16, 1988-9 I.R.B. 7. The Service could then send the FPAA to the selected TMP at his personal address.

Please refer any questions regarding this technical advice to Bill Heard at FTS 566-3289.

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